**IN THE HIGH COURT OF GUJARAT AT AHMEDABAD**

**SPECIAL CIVIL APPLICATION No. 9878 of 2005**
**To**
**SPECIAL CIVIL APPLICATION No. 9892 of 2005**
**With**
**SPECIAL CIVIL APPLICATION No. 10173 of 2005**
**To**
**SPECIAL CIVIL APPLICATION No. 10214 of 2005**
**With**
**SPECIAL CIVIL APPLICATION No. 10329 of 2005**
**To**
**SPECIAL CIVIL APPLICATION No. 10408 of 2005**
**With**
**SPECIAL CIVIL APPLICATION No. 10480 of 2005**
**To**
**SPECIAL CIVIL APPLICATION No. 10548 of 2005**

**For Approval and Signature:**

**HONOURABLE MR.JUSTICE M.R. SHAH**

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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**M/S HITESH K SHAH FINANCIAL SERVICES LTD & 1 - Petitioner(s)**

**Versus**

**UNION OF INDIA & 3 – Respondent(s)**

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**Appearance :**
MR SN SOPARKAR WITH MR SANJAY A MEHTA for Petitioner(s) : 1 - 2.
RULE UNSERVED for Respondent(s) : 1,
MR JITENDRA MALKAN for Respondent(s) : 1,
RULE SERVED for Respondent(s) : 2 - 4.
MR SN SHELAT, ld. Advocate General with MR BIJAL CHHATRAPATI and MR JAY AMIN for SINGHI & CO for Respondent(s) : 2,
MR MRUGESH JANI for Respondent(s) : 3,
MR AMAR N BHATT for Respondent(s) : 4,

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**CORAM : HONOURABLE MR.JUSTICE M.R. SHAH**

**Date : 29/12/2005**

**CAV JUDGMENT**

1. As common question of law and facts arise in these group of petitions, they are being disposed of by this common judgment and order.

2. In this group of petitions, the respective petitioners, registered as stock brokers with SEBI being members of Regional Stock Exchanges and also registered as sub brokers with SEBI of subsidiaries of their parent Regional exchanges, who are registered as sub brokers with SEBI as

members of Bombay Stock Exchange (hereinafter referred to as the “BSE”) and National Stock Exchange (hereinafter referred to as the “NSE”) have challenged the legality and validity of SEBI (Stock Brokers and Sub Brokers) (Amendment) Regulations, 2003 (hereinafter referred to as the “Regulations 2003”); circular being No.SEBI/MIRSD/DSP-1/CIR-31/2004 dated 26-8-2004 and the circular dated 12-5-2005 making the same applicable to the members of the recognized Stock Exchanges operating through the subsidiaries of such recognized Stock Exchanges. By the Regulation 2003, only stock brokers will issue direct contracts to the investors of their sub brokers and the sub brokers shall not issue confirmation memos and the delivery of securities and the payment of funds shall be made directly between stock brokers and the clients of sub brokers.

3. The case on behalf of the petitioners in

nutshell is as under:

SEBI had come into force on 30-1-1992. Section 30 of the said Act empowers SEBI to make regulations with the previous approval of Central Government by notification, consistent with the Act and the Rules made thereunder, to carry out the purposes of the Act. Section 13 of the Securities Contracts (Regulations) Act, 1956 (for short “the Act, 1956”) deal with the contracts in notified areas, which are held to be illegal in certain circumstances. That a member of a Stock Exchange is entitled to enter into a contract on principal-to-principal basis with any member of a Stock Exchange. A member of one particular exchange can enter into a contract on principal-to-principal basis with any member of a Stock Exchange. Section 15 of the Act, 1956 provides that every member of a recognized exchange shall enter into a contract as a member in respect of any securities, only with a member of a recognized Stock Exchange and that he shall do so

with any other person, who is not a member of a recognized exchange, only if he has secured the consent or authority of such person and such concerned authority is disclosed in the note, memorandum or agreement of sale or purchase that he is acting as member. Section 12 of the SEBI Act deals with registration of brokers, sub brokers, share transfer agent, etc. The petitioners, who are registered as share brokers of the Ahmedabad Stock Exchange/Baroda Stock Exchange/Saurashtra and Kutchh Stock Exchanges,as the case may be. Section 2(e) of SEBI (Stock Brokers and Sub Brokers) Rule, 1992 define “Stock Broker” and section 2(f) of SEBI (Stock Brokers and Sub Brokers) Rule, 1992 define “Sub Broker”. As per the circular dated 16-1-1998, the members of the Stock Exchange, who were acting as sub brokers through the members of other Stock Exchanges were required to obtain a certificate of registration from SEBI to act as sub broker under the Rule and Regulations, 1992. Somewhere

in the beginning of the year 1998, the Stock Exchange, Mumbai had requested for SEBI's approval for expansion of BOLT System, all over India including to all the Regional Stock Exchanges. Pursuant to the same, SEBI invited comments/confirmation of its draft circular from all the Regional Stock Exchanges in respect of BOLT expansion by its letter dated 26-2-1998.

It is also the case of the petitioners that in the year 1995, with an intention to facilitate the investors all over the country to trade on one particular Stock Exchange, the SEBI granted permission to carry out trades and transact buying and selling of the securities on the national Stock Exchange by national information on-line trading system. According to the petitioners, said permission thereby permitted the trades to be undertaken on the on-line trading system even in the areas which were notified under section 13 of the Act, 1956. By press release dated 29-10-1996, SEBI inter alia

allowed expansion of Mumbai Stock Exchange terminals to cities other then Mumbai on the terms and conditions stipulated therein. Pursuant to the said permission granted by SEBI a Memorandum of Understanding between Stock Exchange, Mumbai and the Regional Stock Exchanges was entered into. By circular dated 3-4-1998, the requirement for approval of setting up of terminals at Ahmedabad were laid down. Subsequently, it was realized that the trading volumes in the Regional Stock Exchanges were considerably declining, which raised the question of survival of the Regional Stock Exchange and the same became a matter of concern for all concerned. A group was formed by SEBI and a meeting of the said group was held on 8-9-1999 to discuss the suggestion/revival plans forwarded by small exchanges by small exchanges for their survival. The said group considered the suggestion/revival plans submitted by small Stock Exchanges and made certain recommendations, one

of which was permission to be granted for promotion of a subsidiary which can acquire membership right of larger Stock Exchanges viz.NSE/BSE/CSE/DSE or any other Stock Exchanges subject to the usual conditions applicable to other members. SEBI, therefore, decided that small exchanges may promote or float a subsidiary/ company to acquire membership right of other Stock Exchanges subject to certain conditions. Thus, according to the petitioners, the subsidiary promoted/ formed by the members of a Stock Exchange was to be treated as equivalent to all other members of the larger Stock Exchange as the same was permitted to acquire membership right of other Stock Exchanges subject to certain conditions. SEBI issued a circular dated 26-11-1999, whereby certain conditions were laid down which may be required to be complied with by such subsidiary/company which was proposed to be formed. One of the conditions as per the said circular was that no person other than members of

parent Stock Exchange or the exchange itself would be eligible to acquire any share holding in the said subsidiary/company. Thus, according to the petitioners, as per the conditions stipulated in the circular dated 26-11-1999, the subsidiary/company was entitled to register only the members of the Stock Exchange which was promoting the said subsidiary/company as its sub broker and no other client/sub broker was to be entertained by such subsidiary/company. Thus, the Regional Stock Exchange brokers trading through the subsidiaries were required to get themselves registered as sub brokers of the subsidiary and they were required to observe the same capital adequacy norms in respect of the turn over limit, gross exposure and margin as would be applicable to the stock brokers, members of the Stock Exchange, Mumbai (BSE) and the National Stock Exchange of India Ltd. (NSE). Subsequent thereto, the SEBI reviewed the functioning of the subsidiaries and decided that such

subsidiaries/companies shall be required to comply with certain minimum requirements in order to ensure that the transactions in subsidiaries were taken in a manner which are not detrimental to the interest of the investors and also to enable the subsidiaries to provide a safe and transparent mechanism of transaction in securities. Further directions were issued by SEBI vide its circular dated 11-2-2003. Thereafter, SEBI constituted an internal group for reviewing the operation of sub brokers. A concept paper was published on review of capital adequacy, reiterating supervision of sub brokers. The group emphatically recommended that since the SEBI has promoted the members of Stock Exchanges to act as sub brokers to members of other Stock Exchanges, definition of sub broker contained in Rule 2(f) of SEBI Rule, 1992 needs to be changed. Vide circular dated 2-6-003, it was emphatically reiterated by SEBI that “para 2 as per the conditions mentioned in the circular, the

subsidiary/company can register only the members of parent Stock Exchange as sub brokers of the subsidiary/company and no other client/sub broker can be entertained by the subsidiary/company... ... ... ...".

The notification dated 23-9-2003 in respect of amended Regulations 2003 came to be issued in exercise of powers conferred upon the SEBI by section 30 of SEBI Act, 1992. By notification dated 23-9-2003, SEBI made requirement stated therein to amend Regulations of 1992 having resultant effects as under:

*(a) One sub broker shall be affiliated to one member of the exchange. There shall be a privity of contract between the members and a client introduced to the members by the sub broker affiliated to such member. A tripartite agreement has been directed to be entered into by and between the subsidiary, sub broker and the end client of the sub broker;*

*(b) No Director of a cooperate member shall act as a sub broker to the same corporate member;*

*(c) A member shall not deal with a person as a sub broker unless such person has been granted certificate registration by the SEBI;*

*(d) A member shall issue contract directly to the client introduced by his sub broker instead of the sale/purchase note to be issued by the sub broker;*

*(e) The delivery of securities and the payment of funds relating to the transaction shall be made directly between a member and the client introduced by the sub broker affiliated to such member.*

4. After the notification dated 23-9-2003, after about more than a month, SEBI issued a circular dated 28-10-2003 which has been in exercise of

powers conferred upon SEBI under section 11(1) of the Act of 1992 read with section 10 of the Act, 1956 to protect the interests of investors in the securities and promote the development of and to regulate the securities market. It is the case on behalf of the respective petitioners that the said model byelaws have been finalized by SEBI based on the report of the committee appointed by the SEBI itself. According to the petitioners, Clause 2.3.48 of the said model byelaws defines the word 'subsidiary trading member' and it specifically states that subsidiary trading member means and includes a trading member of a subsidiary of a Regional Stock Exchange, where subsidiary has acquired trading-cum-clearing membership of all the exchanges and were such trading members has obtained necessary permission to deal in the securities market as a stock broker from SEBI and/or to exchange as may be permitted from time to time. Thus, according to the petitioners, the sub brokers of a subsidiary

of a Stock Exchange which has acquired membership of BSE/NSE has been treated separately and differently from an ordinary sub broker. Despite the specific directions given by SEBI to the BSE and NSE and all other Stock Exchanges, the NSE and BSE did not carry out the said directions and did not implement the decisions of SEBI which was directed to be implemented immediately and such implementation was required to be communicated to SEBI, which has necessitated the petitioners to pray for a relief of direction to the NSE and BSE to implement the model byelaws as per the directions of SEBI.

According to the petitioners, the circular dated 28-10-2003 is a circular in exercise of powers conferred upon SEBI under section 11(1) of the Securities and Exchange Board of India Act, 1992 read with section 10 of the Act, 1956 and the same has, till date, never been withdrawn and/or modified in any manner whatsoever.

5. According to the petitioners, the status of subsidiary/company of a Regional Stock Exchange is very peculiar in nature and following are the main characteristic of the same.

(a) *Such subsidiary/company of a Regional Stock Exchange is directed by SEBI virtually like an extension of Stock Exchange and its member while dealing with investors operates like stock broker and not like sub broker.*

(b) *Such subsidiary/company of a Regional Stock Exchange has been established pursuant to the revival package formulated by the second respondent for Regional Stock Exchanges in November, 1999.*

(c) *As directed by the second respondent such subsidiary/company is a subsidiary of the Regional Stock Exchange and it cannot undertake any proprietary trade. It can deal with only members of*

*Regional Stock Exchange who are further registered as sub brokers with the second respondent. It cannot deal with other sub brokers or any other client. The board of directors of such subsidiary consists of majority public/Stock Exchange nominees. The member directors are in minority.*

*(d) The members of Regional Stock Exchange who are further registered as sub brokers of such subsidiary/company of the Regional Stock Exchange are required to keep separate deposit with said subsidiary/ company, in addition to the deposit with Regional Stock Exchange of which they are member. The trading/exposure limit as well as margin norms for the members or Regional Stock Exchange dealing with their subsidiary are the same as applicable to those premier Stock Exchange of which such*

*subsidiary or a company is member.*

(e) *The default at such subsidiary or company of the Regional Stock Exchange shall mean default at Regional Stock Exchange also for the members of the respective Regional Stock Exchange operating through its subsidiary/company.*

(f) *The members of the respective Regional Stock Exchanges while operating through its subsidiary/company are subjected to regular inspection requirements like stock broker/trading member.*

(g) *The Investors Grievance Cell of the respective Regional Stock Exchange handles complaints of investors/clients of the Regional Stock Exchange members for operation of a subsidiary/company also.*

6. It is further the case of the petitioners

that subsequent to the issuance of the notification dated 23-9-2003, various representations were made by the stock brokers of such Regional Stock Exchanges through the Federation of India Stock Exchanges and also directly by some of the members of such Regional Stock Exchanges from time to time and the SEBI had been holding various meetings and discussions used to take place upon such representations and therefore,, the implementation of the conditions of a model tripartite agreement envisaged under the said amendment notified on 23-9-2003 was postponed from time to time. It is the case of the petitioners that circular dated 31-3-2005, issued by SEBI in exercise of its powers conferred upon it under section 11(1) of the Securities and Exchange Board of India Act, 1992 treats the sub brokers of subsidiaries of recognized Stock Exchanges, who are registered as stock brokers and their registered sub brokers differently and unequal to other stock brokers

and sub brokers and has clearly stated that special provisions were being made in the SEBI Regulations, 1992 which would be notified shortly. According to the petitioners, the aforesaid circular having been issued, they were assured that SEBI was making special provisions for the petitioners in the SEBI, Regulations, 1992 which were to be notified shortly. While the petitioners were awaiting such notification of separate provisions for them, all of sudden without stating any reason whatsoever, SEBI issued another circular dated 12-5-2005 just within 42 days and intimated its decision that the subsidiaries of the registered Stock Exchange who are registered as stock brokers and their registered sub brokers shall also comply with the provisions of Regulations, 2003 and it was further stated in the said circular that considering the changes that are required in the existing system of the subsidiaries for implementation and compliance with the said

regulations, it has also been decided to allow the said subsidiaries of Stock Exchanges and their sub brokers, to comply with the said regulations from 1-6-2005.

7. According to the petitioners, the implications of making Regulation 2003 applicable to the subsidiaries floated by different Regional Stock Exchanges and their intermediaries are as under:

1. The Regulations 2003 would eliminate over 13,000/- sub brokers who are registered with SEBI. With the implementation of the new Regulations, the problem of loss of identity for sub brokers will become even more acute in the case of intermediaries registered with RSE subsidiaries. The RSE subsidiaries would cease to play an active role on NSE and BSE, just because they have been classified as

sub brokers/ trading members.

2. The new Regulations require the sub brokers to disclose all details about their clients to their principal stock brokers/trading members, including scale of brokerage rates charged to the clients and this would lead to a conflict of interest between the stock brokers/ trading members and their sub brokers, as both the principals and their agents (sub brokers) would be interested in gamering business from the same set of clients. The sub brokers have built up their clientele over long years of dedicated service and their efforts will be reduced to naught in case the sub brokers are eliminated.

3. New Regulations would lead to much grater concentration of the stock broking activity to a limited number of

large-sized members which is detrimental to the balanced and equitable growth of the securities industry and is against the stated objectives of the Government of India and SEBI.

4. Regulations 2003 presuppose a highly efficient banking system encompassing all the banks with electronic funds, transfer facility (EFT) available across the country. However, the inadequacies and inefficiencies of the present banking system would not only come in the way of normal stock trading operations with function on a T + 2 system, but may also lead to scams in the banking industry.

5. At present, the Investor Grievances Cells and the Arbitration mechanisms available at the RSEs are used very effectively by the investors to resolve

> any grievance or dispute against the sub brokers who are affiliated to the RSE Subsidiaries are eliminated and the process of redressal of grievances and disputes of the investors will become more complex. Such grievances and disputes would, therefore, have to be resolved only by the Investor Grievance Cell and the Arbitration mechanism of the main exchange (i.e. NSE and BSE) which adds to cost, complexity and inconvenience for the investors.

It is also further submitted that various representations were made from time to time pointing out implications of the applicability of the said amendment and conditions thereof to the petitioners and the difficulties to be faced by the petitioners upon such applicability. However, SEBI did not take into consideration the same and proceeded with making the said regulations applicable to the petitioners also.

8. It is submitted by Shri Soparkar, learned senior advocate appearing on behalf of the petitioners that sub brokers of subsidiary/company of Regional Stock Exchange are class by themselves and the amendment is contrary to earlier direction issued by SEBI vide circular dated 26-9-1999. It is also further submitted by him that even by circular dated 31-3-2005, it was stated by SEBI that for the petitioners, special provisions are being made in the SEBI Regulations, 1992 which would be notified shortly and therefore, the Amendment Regulations 2003 were not made applicable to the sub brokers of subsidiaries like the petitioners. Therefore, it is submitted that now it is not open for the SEBI to apply the Amendment Regulations 2003 to the petitioners and directing to apply tripartite agreement.

9. It is also further submitted by Shri Soparkar

that as per Section 10 of the Act, 1956, all the exchanges are bound to act as per the advice of the SEBI and when SEBI vide circular dated 28-10-2003 advised the exchanges to amend their bye laws in line with the model bye laws, BSE and NSE are bound to obey the said advice and amend their bye laws and therefore, it is requested to direct respondent Nos.3 and 4 to implement the directions given vide circular dated 28-10-2003 and carry out necessary amendment in its bye laws so far as the same are inconsistent with the mode bye laws.

10. Shri Soparkar, learned senior advocate has relied upon the following decisions of the Hon'ble Supreme Court in the case of;

*(i)M.G. Badappanavar and Another V. State of Karnataka and others reported in (2001) 2 SCC 666*

*(ii)Onkarlal Bajaj and others V. Union of India and another reported in (2003)2 SCC*

*673*

*(iii)Oxford University Press V. Commissioner of Income Tax reported in (2001) 3 SCC 359 (page 35)*

*(iv)Shakuntala Sharma (Mrs) V. High Court of H.P. At Shimla and another reported in (1994) 2 SCC 411 (para 12)*

*(v)Union of India and others V. Ram Gopal Agarwal and others reported in (1998) 2 SCC 589*

Relying upon the aforesaid decisions, it is submitted that equality is a basic feature of the Constitution of India and any treatment of equals unequally or unequals as equals will be violation of the basis structure of the Constitution of India. It is further submitted that as sub brokers of subsidiaries are class by themselves, they are treated at par with the other sub brokers and thus unequals are treated equally.

11. Petitions are opposed by SEBI. Shri SN

Shelat, learned Advocate General appeared with Shri Chhatrapati and Shri Jay Amin for Singhi & Co. for SEBI. Petitions are opposed by mainly submitting as under:

1. The petitioners are registered as sub brokers within the meaning of Rule 2(f) of the SEBI Rules 1992 and the petitioners themselves have admitted that they are registered with SEBI as sub brokers of subsidiary company. SEBI rules have been framed under Section 23 of the SEBI Act and SEBI Regulations have been framed under Section 30 of the SEBI Act and the Rules and the Regulations have force of law and are in the nature of subordinate legislations. Regulations were amended by amendment in Regulations in the year 2003 with effect from 23rd September, 2003. and were enforceable with effect from 23rd September, 2003 in terms of the amended Regulations. However, since the representations were made

on behalf of the petitioners, an administrative decision dated March 31, 2005 was taken not to enforce the said Regulation. Thereafter, having considered the representation received from various interests, it was resolved to enforce regulation uniformly without providing special to the petitioners. The Regulations have been amended after thorough study as reflected from the concept paper. It was recommended that in the absence of privity of contract between the broker and client some time client face difficulty in the court of law in enforcing his claim, when sub brokers have absconded and/or failed to satisfy the dues of the clients. The concept paper, therefore, recommended that there should be tripartite agreement between the broker, sub broker and the client and that contract note is to be issued by the broker through sub broker in favour of the client.

The object for amending Regulation is that the client is sufficiently assured that he can make claim against the broker in spite of the failure of sub-broker in view of the tripartite agreement between the Brokers, Sub Brokers and client and the contract note executed by the Stock Brokers through the Sub Broker in favour of the client. The amendments are in the interest of the Investors and public interest.

2. There was no reason for the SEBI to treat the petitioners, who are sub brokers as a special class other than of sub brokers. Initially, there was a contemplation for treating them separately but from overall consideration of the representations from all the interests, SEBI had resolved to implement the amended regulations.

3. The petitioners have claimed relief on the basis of directions given by the SEBI to the BSE and NSE to adopt the Model Bye-laws, for

a writ of mandamus against them to approve the bye-laws in conformity with the model bye-laws which has been circulated on the basis of the special report. However, at this stage, Model Bye-laws are not enforceable and have not been approved of by the BSE and NSE and there have been representations on behalf of the NSE and BSE as regards the proposed Model Bye-laws. Therefore, no reliefs can be granted on the basis of the Model Bye-laws which have still not come into force. Even, otherwise, assuming the Model Bye-laws are or become applicable, the definition provided in the Model Bye-laws does not confer any legal right in favour of the petitioners. Except the definition section the Model Bye-laws do not refer to the concept of subsidiary trading member. The said definition becomes redundant as thereafter no reference is made to such a class. Definition given in the

Model Bye-laws is not useful to the petitioners as they are neither members of the BSE and NSE. It is only at the instance of the Members that such a relief can be claimed against the BSE and NSE. The Bye-laws do not confer any such right as subsidiary trading member in terms of depositors. Except the definition section there is no further rights flow from the said bye-law. The petitioners cannot rely upon draft Bye-laws for making out a case that they should be separately treated. After proper studies the amendments have been brought in order to protect the Investor from foul play of the sub brokers by making broker responsible for the transaction by providing tripartite agreement and contract note to be issued by the broker through sub broker. The definition of the subsidiary trading member does not define the petitioners as a

distinct class. It recognizes the petitioners as a subsidiary trading member and the second part refers to the permission the subsidiary trading member has obtained to deal in the securities market as a stock broker. Permission to deal as a stock broker would necessarily mean permission to trade as a stock broker at respective Regional Stock Exchange, of which the petitioners are members and not a permission to trade as a stock broker on BSE and/or NSE, as they are merely a registered sub broker.

4. The proposed amendment is not inconsistent with the policy as reflected from the circular dated 26th November, 1999, wherein it is indicated that subsidiary shall not undertake any dealing in securities on its own account.

12. Shri Shelat, learned Advocate General while opposing the present Special Civil Applications,

has submitted that prayer 6(a) seeks exemption from implementation of Securities and Exchange Regulations, 2003, through instrumentality of Article 226 of the Constitution of India on the basis of the Model Bye-Laws, which have not come in force. It is submitted that the Memorandum of Understanding executed between the Stock Exchange, Mumbai and the Stock Exchange, Ahmedabad on 26.6.1997, is not in force today and therefore, there is no need to consider the contents of ht so called Agreement particularly when, the petitioners were registered as a sub-broker with SEBI and has been thereby permitted to trade on BSE and NSE through the subsidiary / company floated by the respective Regional Stock Exchanges, as a sub-broker. It is submitted that the present Special Civil Applications are not maintainable as the subsidiary / company, which has become a Member of BSE and/ or NSE, has not come forwarded before this Court for any relief and the Petitioners are not concerned with the

management and / or affairs of the subsidiary / company. Therefore, the petitioners cannot be permitted to raise any cause on behalf of such subsidiary / company. It is also further that there is no differentiation in the SEBI Regulations between Sub-brokers of a regular Broker or Sub Broker of a subsidiary of Regional Stock Exchange, and though the Regulations applies to the petitioners from the date the petitioners became a Sub- broker, the petitioners seek enactment of separate Regulations for itself through Writ of Mandamus under Article 226 of the Constitution of India, which is not permissible.

13. It is submitted that no mandamus may be issued by this Court to direct a legislative act. It is submitted that in effect, the prayers sought in the present Special Civil Applications are to direct the SEBI to amend the SEBI (Stock Broker and Sub Broker) Regulations, 1992, in order to take the subsidiaries and their sub

brokers out of the scope of the amendments made thereto on September 23, 2003. It is submitted that being a registered sub broker, they are obliged to comply with the provisions of the SEBI Regulations, 1992 and they cannot now back out and plead that the SEBI Regulations does not apply at all to them.

14. It is also further submitted by him that Securities and Exchange Board of India Regulations, 2003 were amended on 23-9-2003 and the same have been made applicable from that date onwards to the petitioners too, except the requirement of execution of tripartite agreement, which stood deferred till 31-3-2005. It is submitted that the execution of tripartite agreement is now mandatory. It is also further submitted that the Securities and Exchange Board of India Regulations, 1992 were applicable to the petitioners from the date the petitioners became sub brokers and therefore, it cannot be said that

amendment made in the said Regulations, do not apply to them.

15. Shri Shelat has drawn the attention of the court to the facts leading to the impugned amendment Regulation, 2003 and submitted that NSE was established in 1994-95 with nation wide electronic trading terminals. The BSE also expanded its trading platform into nation wide electronic BOLT terminals. As a result, a drastic decline was seen in the turnovers of the various smaller Regional Stock Exchanges and consequently in the business of their members. In order to revive these small Stock Exchanges and protect their members, an Expert Committee on revival of smaller Stock Exchanges was constituted by SEBI. Based on the recommendations of the Committee, SEBI had by its circular dated 26-11-1999, permitted these exchanges to form wholly owned subsidiaries which could then obtain membership of larger Stock Exchanges such as NSE and BSE.

The members (stock brokers) of the small exchanges were allowed to become sub-brokers of such subsidiaries to enable them to trade on the BSE/NSE in their capacity. It is submitted that for such members of smaller exchanges to otherwise obtain trading rights as members in the BSE & NSE in view of the huge deposit required to be made for the same high cost of the membership card etc. was difficult, therefore, the SEBI had facilitated the setting up of this model by requesting BSE and NSE to waive some of their requirements and grant membership to the subsidiaries of the smaller exchanges to enable their members to get business. It is also further submitted that even acquiring membership rights of other Stock Exchange by subsidiary company of small Stock Exchanges was also subject to certain conditions. It is submitted that, that does not mean that the normal regulatory regime applicable for carrying on activity of stock brokers and sub brokers would not be applicable to the sub

brokers of the subsidiaries. It is submitted that to continue such activity, the subsidiaries and their sub brokers would have to comply with the applicable regulatory regime and any changes made thereto. It is submitted that till the amendment in question were notified and also thereafter, the sub brokers of the subsidiaries had been following all requirements of SEBI (Stock brokers and Sub brokers) Regulations, 1992 as was being done by the other stock brokers and sub brokers.

16. It is submitted that prior to the impugned Regulations, 2003 two bipartite were required to be entered into one between the stock broker and the sub broker and the other between the sub-broker and his client. In respect of transactions, contract notes would be issued on a consolidated basis by the stock broker to the sub broker and sub broker in turn, issued a purchase or sale note to the client. The sub-broker will make payment/collect moneys to/from clients and

shall also make delivery/receive securities to/from clients in respect of its clients transaction. It is submitted that in light of the fundamental changes undergone in the capital market, SEBI constituted an Internal Group to *inter alia* review provisions relating to capital adequacy, reporting and supervision of sub brokers and the group came out with a concept paper. The group mainly identified the areas of concern relating to (1) Client Agreement (2)Inspection of the books and records (3) Brokers acting as unregistered sub broker (4) Cessation of sub brokership etc.

17. It is submitted that the SEBI considered the report of the group and the public comments were received and SEBI found many infirmities in the operation of the then existing regulatory system and it was found that in case of any default by a client, the sub brokers may default to other clients both in payment and delivery. When sub

brokers defaulted in giving confirmation memos, the client cannot even move for arbitration in case of dispute/default, as he has no document evidencing sale or purchase. Sub brokers at time issued bogus confirmation memos, which were not backed by trades on the system of the exchange. The clients had no means of knowing that his trades were not actually put through the exchange system. It was also found by the SEBI that at times, even where the broker had terminated his relationship with the sub broker, the sub broker had held forth to the client as if he continued to be the sub broker and issued confirmation memos etc. It is submitted that in view of the above and after detailed internal deliberations, Regulations, 2003 were notified on September 23, 2003 and the main changes brought about, were the following-

(a) Agreement with sub broker, client of the sub broker and main broker: A sub broker shall enter into a Tripartite Agreement

with the main stock specifying the scope of rights and obligations of the stock broker, sub broker and such client of the sub broker, to establish privity of contract between the stock broker and the client of sub broker.

(b) Issuance of direct contract note by the stock broker to the clients of the sub broker;

(c) Direct payment of funds/delivery of securities by the stock broker to the clients of the sub broker and vice versa;

(d) Recognition of sub brokers by the respective Stock Exchanges in order to bring Stock Exchanges as the front line regulator for sub brokers as well;

(e) No director of a stock broker shall also be a sub broker to the same stock broker.

18. It is submitted that the main object of the amendment and the Regulations, 2003 as an

investor protection measure so that the investor is aware who is responsible for serving him; and to firmly establish the role of stock brokers vis-a-vis ultimate clients of the sub broker and to make him explicitly responsible towards such clients; and to insulate the client from the defaults of the sub broker and the consequences of their acts of omission and commission. It is submitted that the said amendments were applicable to all stock brokers and sub brokers including subsidiaries and their sub brokers.

19. It is submitted that after the above amendments were notified, SEBI received representations from the market including from the subsidiaries and their sub brokers and therefore, SEBI decided to defer the strict implementation of the amendments vide various circulars. It is submitted that SEBI vide circular dated 26-8-2004 informed the stock brokers and sub broker, including of the

subsidiaries that requirement of Model Tripartite Agreement between the stock broker, sub broker would come into effect from 1-12-2004 and the same was extended upto 1-4-2005. It is submitted that vide circular dated 31-3-2005 SEBI instructed all the exchanges that the amendments would be implemented strictly from April 1, 2005 in respect of stock brokers and sub brokers but the said instruction did not apply to subsidiaries and their sub brokers "for the present". It is submitted that thereafter on a review of the above decision and considering the various representations from certain other broking entities and sub brokers seeking review of the applicability of amendments to them also and it was felt advisable not to have a separate regulatory regime for subsidiaries and their sub-brokers and it was decided that the subsidiaries and its members also will have to comply with the amendments uniformly with other stock brokers and sub brokers and the said decision was conveyed

vide circular dated 12th May, 2005.

20. Meeting with the contention on behalf of the petitioners that earlier a subsidiary was prohibited from entering into contracts with the clients, however, by way of amendment, such subsidiary is compelled to enter into contract with the client directly and therefore, the amendment is contrary to the direction issued by SEBI vide circular dated 26-9-1999, Shri Shelat has submitted that a subsidiary of a Regional Stock Exchange which is a broker on the NSE/BSE, cannot undertake any proprietary business or any business on behalf of its direct clients. It is submitted that prohibition upon the subsidiary/ company from “dealing in securities on its own account” only refers to proprietary business i.e. the stock broker buys or sells shares or securities in his own name. It is further submitted that the obligation to register only the members of the Stock Exchange which is

promoting the subsidiary/company as its sub-brokers and no other client/sub broker to be entertained by the subsidiary/company, only prohibits business on behalf of his direct clients, where the stock broker issues the contract note in favour of such clients. It is submitted that the aforesaid prohibition does not in any manner prohibit such a subsidiary of a Regional Stock Exchange from issuing contract notes in the name of the clients of its sub-brokers. It is submitted that a subsidiary was being permitted to do business on behalf of a sub-broker, wherein the subsidiary buys or sells shares for the clients of a sub broker. It is submitted that prior to the amendment Regulations 2003, the contract note was issued by the stock broker (subsidiary) to the sub broker and the sub broker in turn, issued a purchase or sale note to the client and after the Amendment Regulations 2003, the contract note is required to be issued by the Stock Broker in the name of the client of

the sub broker. Under the new Regulations, sub-broker is obligated to facilitate obtaining of such a contract note from the stock broker. It is submitted that the issuance of contract note by the subsidiary of a Regional Stock Exchange to and in the name of the clients of the sub brokers does not amount to “dealing in securities on its own account”. It is submitted that the requirement of a stock broker issuing a contract note directly in the name of a client of its sub broker is uniformly applied, be it a normal stock broker or a subsidiary of a Regional Stock Exchange, which too is a stock broker. It is submitted that the SEBI Regulations do not differentiate between these two stock brokers. Similarly, there is no differentiation between the sub brokers of a regular broker or sub broker of a subsidiary of Regional Stock Exchange under the SEBI Regulations therefore, it is submitted that it cannot be said that the amendment Regulations 2003 is in conflict with the

directions issued by SEBI in its circular dated 26-9-1999.

21. It is submitted that after 1997, SEBI has mandated that “no broker shall deal with a person who is acting as a sub broker unless he is registered with SEBI as a sub broker.” Therefore, it is submitted that it was the duty cast upon the stock broker to see that his client is not acting in the capacity of a sub broker unless he is registered with SEBI as a sub broker. It is submitted that vide circular dated 26.9.1999 while permitting the Regional Stock Exchanges to float a subsidiary/company, it was stated that the members of the Stock Exchange shall register themselves as sub-brokers of the subsidiary to enable them to trade through the subsidiary. It is submitted that all the petitioners were registered as a sub-brokers of a subsidiary to trade on NSE and/or BSE, through subsidiary as a sub-broker and till date they have acted as a

sub-broker and they are required to follow and comply with the regulations applicable to the sub-broker. It is submitted that the provisions of SEBI (Stock Broker & Sub Broker) Regulations 1992 were not applicable to the petitioners. This being so SEBI (Stock Broker & Sub Broker) (Amendment) Regulations; 2003 would not be applicable to the petitioners as it is only and amendment to Regulations; 1992.

22. It is submitted that there is no differentiation between a sub-broker of a regular stock broker or a sub-broker of a subsidiary of Regional Stock Exchange and therefore, it cannot be stated that the petitioners being sub-brokers of subsidiary are a class by themselves.

Meeting with the submissions on behalf of the petitioners that the SEBI accepted that the petitioners are not a normal sub-broker and are a class by themselves and that it was stated by the SEBI vide circular dated 31.3.2005 that for the

petitioners, special provisions are being made in the SEBI Regulations; 1992 and the same would be notified shortly, it is submitted by Shri Shelat that in fact, vide circular dated 31.3.2005 SEBI instructed all the exchanges that the Amendments would be implemented strictly from April 1, 2005 in respect of stock-brokers and sub-brokers but a decision was taken at the relevant time that the said instructions would not apply "for the present" to subsidiaries and their sub-brokers for whom, special provisions are being made in the Regulations which would be notified shortly. It is submitted that after careful consideration it was felt that having a dual regulatory regime may increase such requests from other brokers and sub-brokers. It is submitted that on review of the above directions, it was felt advisable not to have a separate regulatory regime for the subsidiaries and their sub-brokers, particularly, since it was to be eventually merged with the normal regulatory regime and therefore, it was

decided that the subsidiaries and its members also would have to comply with the amendments uniformly with other stock brokers and sub-brokers. It is submitted that merely because SEBI postponed the implementation of the provisions of the Amended Regulations in respect of the petitioners, it cannot be said that the petitioners have a right to demand that they may be exempted from the rigours of the regulations which were framed with the basic object of investor protection.

23. It is submitted that the petitioners have no right to insist upon enactment of any particular Regulations, as there is no such fundamental right guaranteed to the petitioners. It is submitted that no mandamus would lie to direct the legislature to enact a particular law or regulation. It is submitted that SEBI has not treated unequals as equal. It is submitted that there is no question of treating unequals as

equal, as the petitioners are registered sub brokers under the SEBI Regulations; there is no difference between the sub-broker of the subsidiary and a normal sub-broker. It is submitted that merely because, once it was stated that the requirement of the execution of Tripartite Agreement might not be applicable to the petitioners, the same can never be termed as exemption from the applicability of the SEBI Regulations to the petitioners.

24. Now meeting with the submission on behalf of the petitioners to implement the model bye-laws , it is submitted that such model bye-laws are only model and do not have any statutory force till they are adopted by a Stock Exchange in accordance with Section 9 of the Securities Contracts (Regulation) Act, 1956 and notified both in the Gazette of India and the Official Gazette of the respective State. It is submitted that till today, no such model bye-laws of any

recognized Stock Exchange have attained statutory force by notification in the Gazette of India. It is further submitted that model bye-laws are not implemented by BSE and NSE for many reasons. It is also submitted that as such implementation of the model bye-laws by other exchanges is not the subject matter of the present Special Civil Application. It is submitted that the SEBI advised the exchanges to amend the bye-laws in line with the model bye-laws vide circular dated 28-10-2003. However, the same are to be implemented after following the procedure and therefore, this being so, if BSE and NSE have suggested any changes in the model bye-laws, they cannot be compelled to adopt the same without modification, through the instrumentality of Article 226 of the Constitution of India. It is submitted that in the model bye-laws, subsidiary trading member is referred only in bye law 2.3.48 and on careful consideration of the same, it cannot be said that it contemplates the

petitioners as a distinct class. It is submitted that in the entire model bye laws, there is no further reference to subsidiary trading member providing for special treatment to such subsidiary trading member or empowers them to issue contract notes to their clients. It is also further submitted that even bye-laws are subject to the further direction that may be issued by SEBI. It is submitted that examination of the model bye-laws by the concerned exchange or even by SEBI before its implementation cannot be termed as in violation of the direction issued by SEBI.

25. It is submitted that Article 14 of the Constitution of India does not forbid reasonable classification of persons, objects and transactions by the legislature for the purpose of attaining specific ends. It is further submitted that there is always presumption in favour of the constitutionality of a statue and

laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It is also further submitted that it is only within the domain of the legislature and its delegate to determine the best way to implement and to incorporate substantive and procedural measures for efficacious achievement of the object of the Act.

26. Shri Shelat has relied upon the decision of the Hon'ble Supreme Court in the case of Maharashtra State Board of Secondary and Higher Secondary Education and Anr V. Paritosh Bhupesh Kurmarsheth reported in AIR 1984 SC 1543 and in the case of M/s Sharma Transport V. Govt. of A.P. And Ors. reported in AIR 2002 SC 322 in support of his submission and has submitted that while considering the validity of Regulation, it is not required to be considered the merits of a policy laid down by Regulation making body. He has

relied upon the decisions of the Hon'ble Supreme Court in the case of MD. Usman and Ors V. State of Andhra Pradesh reported in 1971(2) SCC 188 (para 4,5 and 7), in the case of M/s Khodya Distilleries Ltd. etc. V. State of Karnataka and Ors.) (para 13,14,15,16 and 17) reported in AIR 1996 SC 911 in support of his submission and submitted that when the statue oblige every person to do a particular act, no relief for exemption from operation of the provisions of the Act can be granted if the same amounts to policy decision. He has also relied upon the decision of the Hon'ble Supreme Court in the case of the State of J & K V. Triloki Nath Khosa and Ors.) reported in AIR 1974 SC 1 (para 22,24,26,35,37 and 38), in the case of E.V. Chinnaiah V. State of Andhra Pradesh and Ors reported in JT 2005(11) SC 482 (para 10,32,33,34 and 39), in the case of Ashutosh Gupta V. State of Rajasthan and ors reported in AIR 2002 SC 1533 (para 6) and in the case of Pradip Chandra Parija and Ors V. Pramod

Chandra Patnaik and Ors reported in AIR 2003 SC 4506 in support of his submission and has submitted that while considering classification, the judicial scrutiny can extend only to the consideration whether the classification rests on a reasonable basis and whether it bears nexus with the object in view and it cannot extend to embarking upon a nice or mathematical evaluation of the basis of classification. Relying upon the judgments of the Hon'ble Supreme Court in the case of Krishnan Kakkanth V. Govt. of Kerala and Ors reported in AIR 1997 SC 128 and in the case of Pradip Chandra Parija V. Pramod Chandra Patnaik and Ors reported in AIR 2003 SC 4506, it is submitted that a mere hardship cannot be a ground for striking down the valid legislation. Relying upon the judgments of the Hon'ble Supreme Court in the case of Peerless General Finance and Invst. Co. Ltd and Another V. Reserve Bank of India reported in 1992(2) SCC 343 and in the case of State of U.P. And Ors V. Sukhpal Singh Bal

reported in JT 2005(8) SC 115, it is submitted that normally in the field of economic legislation, the Court should be very slow to interfere with the policy decision and it is for the expert body like SEBI to decide and take decision. Relying upon the judgments of the Hon'ble Supreme Court in the case of Suresh Sheth V. Commissioner, Indore Municipal Corporation and Others reported in JT 2005(9) SC 210 and in the case of A.K. Roy V. Union of India and Another reported in AIR 1982 SC 710, it is submitted that no direction can be issued directing the executive to enact delegated legislation and relying upon the same, it is submitted that the prayer of the petitioners directing the BSE and NSE to accept model bye laws and amend the bye-laws accordingly cannot be granted. At last Shri Shelat has submitted that as the amended Regulations, 2003 are to protect the investors and pubic at large and in public interest, he has requested to dismiss the Special Civil

Applications.

27. Heard the learned advocate appearing on behalf of the parties.

28. The respective petitioners have prayed for an appropriate order directing the respondent SEBI and other exchanges i.e. BSE and NSE etc. not to treat and consider the sub brokers of subsidiaries/companies of Regional Stock Exchanges equal to or at par with the other sub brokers as defined in rule 2(f) of the SEBI (stock brokers and sub brokers) Regulations 1992. It is also further prayed that the petitioners who are sub brokers of the subsidiaries/companies of Regional Stock Exchange be treated and considered as Subsidiary Trading Members as defined and/or referred to in the model bye laws published by SEBI on 27th October, 2003 and not make the provisions of the Regulations, 2003 applicable to the sub brokers of the subsidiaries

or Regional Stock Exchanges. It is also further prayed to quash and set aside the circular dated 26-8-2004 issued by SEBI by which the SEBI has formulated uniform set of documents which are required to be complied with by the stock brokers, sub-brokers and subsidiaries of all the Stock Exchanges. The petitioners have also challenged the communication dated 12th May, 2005 of the SEBI by which the SEBI has issued the circular making amendment Regulations 2003 applicable to sub brokers of subsidiaries/ companies of Regional Stock Exchanges also. It is also further prayed by the petitioners that NSE and BSE be directed to implement the directions given by the SEBI by circular dated 28-10-2003 to amend their bye-laws as per the model bye laws. The sum and substance of the reliefs, sought by the respective petitioners are (1) not to implement the Regulations 2003 so far as the sub-broker of subsidiaries/companies of Regional Stock Exchange (2) to direct the BSE and NSE to

amend their bye laws as per the model bye laws (3) to amend the Regulations in such a manner that sub brokers of subsidiaries/companies of Regional Stock Exchanges be treated as a separate class and to legislate the Regulations accordingly.

29. At the outset, it is required to be noted that none of the petitioners have challenged either the provisions of SEBI (Stock broker and Sub broker) Regulations, 1992 and/or SEBI (Stock broker and Sub broker) (Amendments), Regulations 2003. For the aforesaid reliefs, the respective petitioners have mainly relied upon the recommendations of the committee constituted by SEBI issued vide circular dated 26-11-1999; the provisions of the model bye laws, more particularly, definition of subsidiary trading member (model bye law No.2.3.48) and the circular dated 31st March, 2005 issued by SEBI not to implement and apply the Amendment Regulations

2003 so far as sub brokers of subsidiaries/ companies of Regional Stock Exchanges are concerned. At this stage, some back ground is required to be considered. NSE was established in 1994-95 with nation wide electronic trading terminals. The BSE also expanded its trading platform into nation wide electronic BOLT terminals. As a result, a drastic decline was seen in the turnovers of the various smaller Regional Stock Exchanges and consequently in the business of their members. In order to revive these small Stock Exchanges and protect their members, an Expert Committee on revival of smaller Stock Exchanges was constituted by SEBI. Based on the recommendations of the Committee, SEBI had by its circular dated 26-11-1999, permitted these exchanges to form wholly owned subsidiaries which could then obtain membership of larger Stock Exchanges such as NSE and BSE. The members (stock brokers) of the small exchanges were allowed to become sub-brokers of

such subsidiaries to enable them to trade on the BSE/NSE in their capacity. It is required to be noted that but for the circular dated 26-9-1999, the members of the small exchanges would not have been in a position to obtain trading rights in the BSE and NSE. It is required to be noted that for the purpose of obtaining trading rights in the BSE and NSE, a member is required to have the membership card. It appears that SEBI had facilitated the setting up of this model by requesting BSE and NSE to waive some of their requirements and grant membership to the subsidiaries of the smaller exchanges to enable their members to get business. Even by circular dated 26-9-1999, certain conditions were imposed and the subsidiaries and their sub-brokers were required to comply with the applicable regulatory regime and any changes made thereto. It appears that prior to the impugned Regulations, 2003 two bipartite agreements were required to be entered into one between the stock broker and the sub-

broker and the other between the sub broker and his client. In respect of transactions, contract notes would be issued on a consolidated basis by the stock broker to the sub broker and sub broker in turn, issued a purchase or sale note (confirmation memo) to the client and the sub broker will make payment/collect moneys to/from clients and shall also make delivery/receive securities to/from clients in respect of its clients transaction. It is the case of the petitioners that in light of the fundamental changes undergone in the capital market, SEBI constituted an Internal Group to *inter alia* review provisions relating to capital adequacy, reporting and supervision of sub-brokers and the group came out with a concept paper. The group identified certain areas of concern relating to Client Agreement, Inspection of the books and records, brokers acting as unregistered sub-broker and Cessation of sub brokership etc and considering the report of the group and the

different comments received, SEBI found many infirmities in the operation of then existing regulatory system and it was found that in case of any default by a client, the sub-brokers may default to other clients both in payment and delivery; -When sub brokers defaulted in giving confirmation memos, the client cannot even move for arbitration in case of dispute/default; as he has no document evidencing sale or purchase. -Sub brokers at time issued bogus confirmation memos, which were not backed by trades on the system of the exchange; -Even where the broker had terminated the relationship with sub-broker, the sub-broker continue to enter into transaction and do the business and issue confirmation memos. Considering the aforesaid infirmities, SEBI took a decision to amend the SEBI (Stock broker and sub broker) Regulations, 1992 and accordingly SEBI(Stock broker and sub broker) (Amendment) Regulations, 2003 came to be notified and they came to be enacted. It appears that the Amendment

Regulations 2003 are brought to protect the interest of the investors and the main changes which are brought by the aforesaid Regulations 2003 are as under:

(a) Agreement with sub broker, client of the sub broker and main broker: A sub broker shall enter into a Tripartite Agreement with the main stock specifying the scope of rights and obligations of the stock broker, sub broker and such client of the sub broker, to establish privity of contract between the stock broker and the client of sub broker.

(b) Issuance of direct contract note by the stock broker to the clients of the sub broker;

(c) Direct payment of funds/delivery of securities by the stock broker to the clients of the sub broker and vice versa;

(d) Recognition of sub brokers by the respective Stock Exchanges in order to

bring Stock Exchanges as the front line regulator for sub brokers as well;

(e) No director of a stock broker shall also be a sub-broker to the same stock broker.

It appears that considering the various representations, though the Amendment Regulations 2003 were notified, the requirement of model tripartite agreement between the stock broker, sub broker and client were postponed/extended from time to time, however, by circular dated 31-3-2005, SEBI instructed all the exchanges that the amendments would be implemented strictly from April 1, 2005 in respect of stock brokers and sub-brokers but the said instruction did not apply to subsidiaries and their sub brokers "for the present". It appears that at the relevant time, SEBI took a decision to implement the requirement of Amendment Regulations relating to changes in role of sub-brokers and their main brokers including format of the model tripartite agreement only to other sub-brokers of main

broker and at the relevant time, SEBI took a decision not to apply the said instruction "for the present" to sub-brokers subsidiaries of recognized Stock Exchanges which are registered as stock-brokers and through registered sub-brokers. It appears that such a decision was taken at the relevant time as some changes were under contemplation and the SEBI was considering the status of sub brokers of the subsidiaries of the recognized Stock Exchanges. It appears that thereafter, SEBI took a conscious decision to apply and implement the requirements of Amendment Regulations 2003 relating to changes in role of sub brokers and their main broker including format of model tripartite agreement to the sub brokers of subsidiaries/companies to Regional Stock Exchange also. It also appears that prior thereto SEBI proposed model bye laws and to amend the definition of subsidiaries trading member and direct and advise all the Stock Exchanges vide circular dated 28-10-2003 to amend the respective

bye laws of concerned Stock Exchanges inclusive of BSE and NSE accordingly. The petitioners have heavily relied upon the said circular dated 28-10-2003 in support of their relief directing the BSE and NSE to amend their respective bye laws so far as the same are inconsistent with the model bye laws.

30. It is required to be noted that the respective petitioners are the members of Regional Stock Exchange and as such are stock brokers of respective Stock Exchanges and are registered as a sub broker of respective subsidiaries of Regional Stock Exchange. Thus, all the petitioners are as such Sub brokers and the provisions of the Securities and Exchange Board of India (Stock brokers and sub brokers) Rules, 1992 are applicable to them since the very beginning. Due to the fact that NSE was established with nationwide electronic trading terminals and the BSE also expanded its trading

platform into nation wide electronic BOLT terminals. As a result, a drastic decline was seen in the turnovers of the various smaller Regional Stock Exchanges and consequently in the business of their members to give some relief to them and on the basis of the recommendation of the expert body on revival of smaller Stock Exchanges, SEBI vide circular dated 26-11-1999 permitted the smaller exchanges to form wholly owned subsidiaries which could then obtain membership of larger Stock Exchanges such as NSE and BSE and the members (stock brokers) of the small exchanges were allowed to become sub-brokers of such subsidiaries to enable them to trade on the BSE/NSE in their capacity, vide circular dated 26-9-1999. Otherwise, the respective petitioners were not in a position to trade in the BSE/NSE as sub brokers without registration. As per rule 3 of the Rules 1992 no stock broker or sub broker shall buy, sale, deal in securities unless he holds a certificate

granted by the Board under the Regulation. Even granting of certificate to a sub broker by the Board is also subject to the conditions as envisaged under Rules 1992. As per Regulation 11 of the Regulations 1992 made in exercise of powers conferred by Section 30 of the SEBI Act, 1992, an application by sub broker for the grant of certificate shall be made in “form B”. Such application for registration shall be accompanied by a recommendation letter in “form C” from a stock broker of a recognized Stock Exchange with whom he is to be affiliated along with two references including one from his banker and the said application form was required to be submitted to the Stock Exchange of which the stock broker, with whom he is to be affiliated is a member, and the Stock Exchange on receipt of such an application, was required to verify the information contained therein and also certified that the applicant is eligible for registration as per criteria specified in special Regulation

5. As per regulation 18(b), the stock broker shall not do any business with any person as a sub-broker unless such person has been granted certificate of registration by the Board. As per form B, the proposed sub broker was required to mention the name of the sub broker and the Stock Exchange to which he is affiliated. Thereafter, registered as a sub broker, he can trade in the respective Stock Exchange. Thus, for the purpose of trading in the BSE/NSE, the petitioners were required to get themselves registered as a sub broker of stock broker of BSE/NSE. For the reasons as stated above, at the relevant time, a decision was taken to give certain benefits and exemption by virtue of which they were permitted to trade in the BSE/NSE as a sub broker of subsidiaries of Regional Stock Exchange and the concerned subsidiaries/companies of the Regional Stock Exchanges were registered with the concerned Stock Exchanges i.e. BSE and NSE. Meaning thereby, the subsidiaries of the Regional

Stock Exchanges were the stock brokers of BSE and NSE and as a sub broker of subsidiaries by virtue of aforesaid circular dated 26-9-1999, they were permitted to trade in the BSE and NSE. Subsequently, in light of the fundamental changes undergone in the capital market, SEBI constituted an Internal Group to *inter alia* review provisions relating to capital adequacy, reporting and supervision of sub brokers and the group came out with a concept paper before certain areas were identified concerning client agreement, inspection of books and record, broker acting as unregistered sub broker, cessation of sub brokership etc and considering the report submitted by the group and the public comments, SEBI found certain infirmities in the operation of then existing regulatory system and SEBI (stock broker and sub broker) (Amendment) Regulation, 2003 came to be notified in the interest of the investors. It appears that and according to SEBI, the amendments are brought in

as an investor protection measure so that the investor is aware who is responsible for serving him; and to firmly establish the role of stock brokers vis-a-vis ultimate clients of the sub-broker and to make him explicitly responsible towards such clients; and to insulate the client from the defaults of the sub-broker and the consequences of their acts of omission and commission and the main changes brought about by Amendment Regulations 2003 are already reproduced hereinabove and on going through the same, it appears to the court that they are in the interest of the investors as now by virtue of the same, tripartite agreement is required to be entered into between the stock broker, sub broker and client of the sub broker to establish privity of contract between stock broker and the client of sub broker and ultimately the stock broker will be responsible for payment etc. Looking to the representations, the requirement of model tripartite agreement between the stock broker,

sub broker and the client was postponed. However, vide circular dated 31-3-2005, the same was made applicable to all the stock brokers and sub brokers, but in view of the fact that SEBI contemplated some further provisions in favour of sub-broker of subsidiaries, it was at the relevant time decided not to apply the said provisions to the sub brokers of the subsidiaries of Regional Stock Exchange and after careful consideration the SEBI took a decision to apply all the provisions and the requirements of amended Regulations 2003 by the sub broker of the subsidiary Regional Stock Exchange also.

31. It is the contention on behalf of the petitioners that the amendment is contrary to the earlier direction issued by SEBI vide circular dated 26-9-1999. It is required to be noted that Rule 92 and Regulation 92 were already there and the provisions were already there as stated hereinabove. However, by aforesaid circular dated

26-9-1999, certain benefits were given to the sub-brokers of subsidiaries and it can be said that by the Amendment Regulations 2003, Regulations 1992 are made more explicit and clear and it can also be said that the benefit which were given in the year 1999 by the aforesaid circular are withdrawn. As stated above, as such the petitioners could not have trade in the NSE/BSE without any registration as per the Rules and Regulations of 1992. If the contention on behalf of the petitioners are accepted then it can be said that all the petitioners were permitted to trade in NSE/BSE without their names being registered as a sub broker of stock broker of BSE/NSE, which is not permissible at all. They cannot be permitted to trade in BSE/NSE without getting themselves registered as sub broker with NSE/BSE. May be for certain reasons, they might have been permitted but when SEBI as an expert body has taken a conscious decision to amend the rules, which are

not under challenge at all, the petitioners cannot be exempted from the statutory provisions.

32. On the basis of the above circular of 1999 and subsequent circular dated 31-3-2005, it is the contention on behalf of the petitioners that they are class by themselves, which cannot be accepted. The petitioners are sub brokers and are governed by Rules of 1992 and Regulations of 1992 and now Amendment Regulations 2003. It is the policy decision of the SEBI which is reflected in the Amendment Regulations 2003. When the petitioners are treated at par with other sub broker, it cannot be said that unequals are treated as equals. Both are sub brokers and a decision has been taken that all the sub brokers be treated equally and all the sub brokers are required to comply with the requirements of Amendment Regulations 2003 inclusive of the format of the model tripartite agreement and all the Stock Exchanges are informed accordingly by

circular dated 12-5-2005, by which it cannot be said that it is illegal and/or dehors the provisions of the statute. Merely because some special benefits were given earlier and/or it was under contemplation, the petitioners cannot be said to be of class by themselves and/or cannot be considered as separate class of sub broker.

33. There is no statutory provision and/or any provisions shown by the petitioners by which the sub brokers of subsidiary/company of Regional Stock Exchanges can be treated as special class of sub broker. Merely because, in the year 1999 some benefit was given at the relevant time and due to that benefit, the petitioner cannot be said to be a special class of sub-broker. Looking to the prevailing situation at the relevant time, if some benefits were given and are subsequently withdrawn and/or all the sub-brokers are treated at par, it cannot be said that the action/decision of the SEBI is wholly arbitrary

and/or illegal and/or contrary to the statutory provisions. Under the circumstances, the contention on behalf of the petitioners to treat them as separate class of sub-brokers cannot be accepted and their prayer not to treat and not to consider the sub brokers of subsidiaries/ companies of Regional Stock Exchanges, equal to or at par with other sub brokers as defined in Rule 2(f) of the SEBI (Stock brokers and sub brokers), Regulation, 1992 cannot be granted.

34. Another prayer of the petitioners is to treat and consider the sub-brokers of the subsidiaries/ companies of Regional Stock Exchanges as subsidiary trading member as defined and/or referred to in the model bye-laws published by the SEBI on 27th October, 2003 is concerned, it is required to be noted that as on today, model bye laws are proposed model bye laws and the have not been accepted by the other exchanges like NSE and BSE. Therefore, on the basis of the model bye

laws, which are yet not become part of the bye laws of the respective stock exchanges, the said prayer cannot be granted. The aforesaid model bye laws are to be adopted by the respective stock exchanges in accordance with Section 9 of the Act, 1956 and are required to be notified both in the Gazette of India and the official Gazette of the respective state and the said eventuality has not taken place and therefore, the prayer of the petitioners cannot be accepted. It appears from the record that the model bye laws are not implemented by the BSE and NSE and they are still considering to implement the model bye laws and from the correspondence and the affidavit-in-reply filed by the BSE, it appears that there are certain reservations of the respective stock exchanges to implement the model bye laws and they have suggested some changes in the model bye laws before its adoption.

35. It is also contended on behalf of the

petitioners that under Section 10 of the Act, 1956 and the Regulations, respective stock exchanges are bound to obey the directions/advice of the SEBI and that as the respective stock exchanges i.e. BSE and NSE have not implemented and/or acted as per the advice of the SEBI vide circular dated 28-10-2003, it is prayed to direct the respective stock exchanges more particularly BSE and NSE to implement their bye laws in line with the model bye laws. It is required to be noted that BSE and NSE have represented to the SEBI for amendment in the bye laws and/or changes in the proposed bye laws. If for valid reasons, BSE and NSE have yet not amended their bye laws considering the proposed changes, no relief can be granted directing the NSE and BSE to amend the bye laws as in line with the model bye laws. This Court in exercise of powers under Article 226 of the Constitution of India, would not like to sit as a Appellate authority over the decision of the expert body and direct to enact a particular bye

law and such an exercise would be beyond the jurisdiction of this Court in exercise of powers under Article 226 of the Constitution of India. Under the circumstances, considering the procedure which is required to be followed as contemplated under Section 10 of the Act, 1956 read with Rule 18 of the Securities Contracts (Regulations) Rule, 1956, the prayer of the petitioners to direct the NSE and BSE to amend their bye laws in line with the model bye laws cannot be granted.

36. Now so far as the challenge to the circular datd 26-8-2004 bearing No.SEBI/MIRSD/DSP-1/CIR-31/2004 and the circular dated 12th May, 2005 is concerned, it is required to be noted that by the aforesaid circulars, SEBI has directed all the stock exchanges to comply with the documentary requirements uniformly by all the stock exchanges and to implement the amended Regulations, 2003 and by circular dated 12th May, 2005, it has also

been decided that the documentary requirements such as Client Registration Form, Client Agreement, Tripartite Agreement etc, will have to be complied with by the sub brokers of the subsidiaries/companies of the Regional Stock Exchanges also. It is to be noted that the aforesaid requirement is as per the Regulations 2003 which are not under challenge. When a circular has been issued to implement the statutory provisions, it cannot be said that there is any illegality. By circular dated 12th May, 2005, a policy decision has been taken to treat all the sub brokers at par and to implement the amended Regulations, 2003 and other requirements by all the sub brokers. The decision has been taken by the SEBI after careful consideration. It is required to be noted that SEBI is an expert body constituted under the provisions of the Act consisting of experts and adviser. As held by the Hon'ble Supreme Court in the case of Peerless General Finance and

Investment Co. Limited (supra), the Act assigns the power to the SEBI to regulate the system. It is further held by the Hon'ble Supreme Court that the experimentation of the economic legislation can best be left to the executive unless it is found to be unrealistic or manifestly arbitrary. It is also held that even if a law is found wanting on trial, it is better that its defects should be demonstrated and removed than that the law should be aborted by judicial fiat. The Hon'ble Supreme Court has further observed that the Court has to see whether the scheme, measure or regulation adopted is relevant or appropriate to the power exercised by the authority and prejudice to the interest of depositors is a relevant factor. In para 31 of the aforesaid decision, the Hon'ble Supreme Court has held that *"the function of the Court is to see that lawful authority is not abused but not to appropriate to itself the task entrusted to that authority. It is well settled that a public body invested with*

*statutory powers must take care not to exceed or abuse its power. It must keep within the limits of the authority committed to it. It must act in good faith and it must act reasonably. Courts are not to interfere with economic policy, which is the function of experts. It is not the function of the Courts to seat in judgment over matters of economic policy and it must necessarily be left to the expert bodies. In such matters, even experts can seriously and doubtlessly differ. Courts cannot be expected to decide them without even the aid of experts."* Thus, the prayer of the petitioners to quash and set aside the aforesaid regulations also cannot be accepted.

37. In background of the above fact situation; the relevant provisions of the amended Regulations, 2003; the circulars and the policy decision of the SEBI, the judgments cited at the Bar on behalf of the respective parties are required to be considered. So far as the judgment

cited at the Bar on behalf of the petitioners referred to hereinabove are concerned, they are on the issue that unequals cannot be treated equals. As discussed hereinabove, there is no question of treating unequals as equals in the present case. As observed earlier, the petitioners cannot be said to be a separate class of sub-brokers. All the petitioners are sub-brokers and there is no distinction under the statutory provision between the sub brokers of subsidiaries/ companies of Regional Stock Exchanges and that of sub brokers of the principal brokers of stock exchanges. Earlier, also the petitioners were governed by the Rules, 1992 and by amendment of Regulations, 2003, Regulations of 1992 are further amended. Under the circumstances, the aforesaid judgments cited at the bar on behalf of the petitioners are not of any assistance to them.

38. In the case of Maharashtra State Board of

Secondary and Higher Secondary Education (supra), the Hon'ble Supreme Court has observed that it would be wholly wrong for the Court to substitute its own opinion for that of the legislature or its delegate as to what principle or policy would best serve the objects and purposes of the Act and to sit in judgment over the wisdom and effectiveness or otherwise of the policy laid down by the regulation making body and declare a regulation to be ultra vires merely on the ground that in view of the Court, the impugned provisions will not help to serve the object and purpose of the Act. So long as the body entrusted with the task of framing the rules or regulations acts within the scope of the authority conferred on it, in the sense that the rules or regulations made by it have a rational nexus with the object and purpose of the Statute, the court should not concern itself with the wisdom or efficaciousness of such rules or regulations. It is also observed by the Hon'ble Supreme Court in the said decision

that it is exclusively within the province of the legislature and its delegate to determine, as a matter of policy how the provisions of the Statute can best be implemented and what measures, substantive as well as procedural would have to be incorporated in the rules or regulations for the efficacious achievement of the objects and purposes of the Act. It is not for the Court to examine merits or demerits of such a policy because its scrutiny has to be limited to the question as to whether the impugned regulations fall within the scope of the regulation making power conferred on the delegate by the Statute.

39. In the case of M.D. Usman (supra), the Hon'ble Apex Court has observed that validity of a rule has to be judged by assessing its over all effect and not by picking up exceptional case, what the Court has to see is whether the classification made is a just one taking all

aspects into consideration. In the present case, the petitioners are not on a better footing then the other sub brokers, merely because they are members of subsidiaries. Otherwise, the petitioners cannot be the broker of another stock exchanges i.e. BSE and NSE and they could not have been permitted to business with BSE/NSE. Whatever the rules and the bye laws are applicable to the sub brokers of BSE/NSE, they are applicable to the petitioners also.

40. In the case of M/s Khoday Distilleries Limited (supra), the Hon'ble Supreme Court has observed that “the tests of arbitrary action which apply to executive action do not necessarily apply to delegated legislation. In order that delegated legislation can be struck down, such legislation must be manifestly arbitrary; a law which could not be reasonably expected to emanate from an authority delegated with the law making power”. The Hon'ble Supreme

Court has further observed in the said judgment that “the fact, however, remains that any concession which is granted by the State or export sales or inter-state sales is a matter of policy. Granting of such concession or absence of such concession cannot make the rule itself manifestly, arbitrary or unreasonable if the appellants are aggrieved by the existing rules or would like a similar concession to be extended to sales which are to be made to MSIL in respect of export orders or orders for supply outside the state received by it, it is open to them to make a suitable representation to the State Government. The absence of availability of such a concession, however, cannot make the rules arbitrary or violative of Article 14.

41. In the case of Ashutosh Gupta (supra), the Hon'ble Supreme Court has considered the concept of equality. Para 6 of the said judgment reads as under:

*"The concept of equality before law does not involve the idea of absolute equality amongst all which may be a physical impossibility. All that Art. 14 guarantees is the similarity of treatment and not identical treatment. The protection of equal law does not mean that all laws must be uniformed. Equality before the law means that among equal the law should be equal and should be equally administered and that the likes should be treated alike. Equality before the law does not mean that things which are different shall be treated as though they were the same. It is true that Art. 14 enjoins that the people similarly situated should be treated similarly but what amount of dissimilarity would make the people dis-entitle to be treated equally is rather a vexed question. A Legislature which has to deal with diverse problems arising out of an infinite verity of human relations must of necessity, have the power of making special laws, to attain particular object; and for that purpose it must*

*have large powers of selections or classification of person and things upon which such laws are to operate. Mere differentiation or inequality of treatment does not "per se" amount to discrimination within the inhibition of the equal protection clause. The State has always the powers to make classification on the basis of rational distinctions relevant to the particular subject to be dealt with. In order to pass the test of permissible classification, two conditions must be fulfilled, namely : (i) that the classification must be founded on an intelligible differentia which distinguishes persons or things that are grouped together from others who are left out of the group, and (ii) that that differentia must have a rational relation to the object sought to be achieved by the act. What is necessary is that, there must be a nexus between the basis of classification and the object of the act. When a law is challenged as violative of Art.14, it is necessary in the*

*first place to ascertain the policy underlying the statute and the object intended to be achieved by it. Having ascertained the policy and the object of the act, the Court has to apply a dual test in examining the validity, the test being whether the classification is rational and based upon an intelligible differentia which distinguished persons or things that are grouped together from others that are left out of the group, and whether the basis of differentiation has any rational nexus or relation with its avowed policy and objects. In order that a law may be struck down under this Article, the inequality must arise under the same piece of legislation or under the same set of laws which have to be treated together as one enactment. Inequality resulting from two different enactments made by two different authorities in relation to the same subject will not be liable to attack under Art. 14. It is well settled Art. 14 does not require that the legislative*

*classification should be scientifically or logically perfect. If we examined the impugned provisions of the Emergency Recruitment Rules from the aforesaid standpoint. The conclusion is irresistible that the aforesaid set of Rules have been framed for a specific recruitment to the Administrative Service. The provisions of Section 25 dealing with the seniority has been specifically decided to meet all situations under which people from different walks of life could be recruited to the Rajasthan Administrative Service under the Emergency Recruitment Rules. The law making authority must be presumed to have examined pros and cons in making the aforesaid provision or seniority in the cadre which is in pari-materia with similar provisions for recruitment to the Indian Administrative Service, and therefore, it is difficult for us to hold that the aforesaid provision is discriminatory in nature."*

42. In the case of Prafulla Kumar Das (supra), the Hon'ble Supreme Court has observed that a mere hardship cannot be a ground for striking down the valid legislation. In the case of Sukhpal Singh Bal (supra), relying upon the earlier decision of the Hon'ble Supreme Court in the case of Bhavesh D Parish and others V. Union of India and others reported in (2000)5 SCC 471, the Hon'ble Supreme Court has observed that while considering the scope of economic legislation as well as the tax legislation, the courts must bear in mind that unless the provision is manifestly unjust or glaringly unconstitutional, the courts must show judicial restraint in interfering with its applicability. Merely because a statute comes up for examination and some arguable point is raised, the legislative will should not be put under a cloud. It is now well settled that there is always a presumption in favour of the constitutional validity of any legislation unless the same is set aside for breach of the

provisions of the Constitution. The system of checks and balances has to be utilized in a balanced manner which the primary objective of accelerating economic growth rather than suspending its growth by doubting its constitutional efficacy at the threshold itself.

43. Considering the aforesaid decisions of the Hon'ble Supreme Court and the object and purpose of amendment Regulations 2003 and the decision of the SEBI for uniformly documentary requirements for treating by all the sub-brokers at par and directing the sub brokers of the subsidiaries/companies of the Regional Stock Exchanges to comply with the same, is for the benefit and in the interest of the investors, the petitioners are not entitled to any relief as prayed for, more particularly in absence of any challenge to the SEBI (Stock Brokers and Sub Brokers) (Amendment) Regulations, 2003.

44. For the reasons as stated above, all the petitions are required to be dismissed and are accordingly dismissed. Rule is discharged in each of the petition. No costs.

(M.R.SHAH,J.)

shekhar/-